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MARKET ACCESS SECRETARIAT
Global Analysis Report

Retail Innovation

Tesco in the United Kingdom

June 2016

EXECUTIVE SUMMARY

Grocery retailing has evolved rapidly over the last decade. The digital transformation of the industry and fierce competition has encouraged retailers to shift their efforts toward Multi-Channel retailing. Meanwhile, recent economic events have spurred retailers to look for opportunities to reduce costs and increase operational efficiencies through IT infrastructure investments, while also adjusting their strategies for growth.

Tesco, the largest grocery retailer in the United Kingdom (U.K.), and has been a leader in retail innovation both at home and abroad for a number of years. However, 2014 was a difficult year for Tesco, the company's global sales dropped by 3%, which made Tesco the only one of the top 10 retailers to suffer a decline. This caused Tesco to sell its non-retail subsidiaries Blinkbox, Tesco broadband and phone services, and they are attempting to sell their datamining firm, dunnhumby. With the sale of these assets, Tesco will be reinvesting in their current stores and opening new Tesco Express stores in convenient locations.

Even with the decline in sales, Tesco's home-shopping grocery network, offered through the retailer's largest online banner *Tesco.com*, is recognized as the U.K.'s most successful online grocery retailing model and posted an operating profit for the 2014 year.

This report identifies two fields of innovation currently being undertaken by Tesco: Multi-Channel Retailing, and finding efficiencies in the supply chain. The objective of this report will be to describe how these approaches are being used by the retailer to maintain and capture new market share and how this way of doing business will ultimately affect Canadian exporters.

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TESCO: COMPANY SNAPSHOT

Tesco is a U.K.-based international grocery and general merchandising retail chain, with a presence in 14 countries, including South Korea, Thailand and Ireland. It is the largest retailer in the U.K., operating hypermarkets and superstores, and is growing its share of smaller stores and online sales.

Tesco, U.K., Grocery Banner Sales, US$ Millions						
Year	**2014**	**2015[E]**	**2016[F]**	**2017[F]**	**2018[F]**	**2019[F]**
Banner Sales	57.8	55.3	56.4	57.8	59.4	61.0
Outlets	3,618	3,651	3,721	3,793	3,863	3,934

Source: Planet Retail 2015, **E**= Estimate, **F**= Forecast

Tesco is projected to have a decline in sales for 2015 as they adjust their strategies, but after that it is projected there will be moderate growth through 2019. The company has a number of ways to reach consumers:

- **Tesco Extra**: is a hypermarket that is mainly located out-of-town in suburbs, it stocks almost all of Tesco's products.
- **Tesco**: is a superstore, which holds standard groceries and a small range of non-food goods.
- **Tesco Metro**: is a supermarket, found mostly in city centres and near train stations for ease of use.
- **Tesco Express**: is a convenience store, these are found in busy city centre districts and because of their small size their prices are a bit higher than their larger stores.
- **One Stop**: is a convenience store, normally found in smaller communities.
- **Tesco.com**: is their online store, both food and non-food products are available to purchase.

Sales are declining for the 4 big UK retailers (Tesco, Sainsburys, Asda-Walmart, and Morrisons) as they are facing tough competition from the German Discounters, Aldi & Lidl. The rise of the discounters is showing no signs of going away, even with the end of England's recession. Because of this Tesco is in a transition; they are in the process of selling some of their assets. The have already sold their two branches, Blinkbox and Tesco broadband and phone services, and they are in the process of trying to sell off dunnhumby. Once these are sold they will be able to use the proceeds to reface/update their current stores. Their plan is to make their stores more attractive and convenient to consumers (news.sky.com, 2015).

Recently, there has been a scandal that has come to light involving the way Tesco treats their suppliers and how they receive income from their suppliers. Tesco was making their purchasing agreements with suppliers exceedingly complicated. There is 24 different ways that Tesco can bill a supplier, and there is a goal to bring that down to only three (volume, premium positioning on the grocer's shelves, and compensation for items that have to be recalled). Because of this, Tesco is now working hard to rebuild their relationships with suppliers (Telegraph UK, Feb 2015).

MULTI-CHANNEL RETAILING

Multi-Channel retailing has become a dominant theme for retailers in the 21st Century, and Tesco has taken a leading role in seizing the opportunities that Multi-Channel retailing has to offer.

Future market trends in the grocery retail industry point to a growing importance for versatile stores with a narrower and more relevant product portfolio. Furthermore, thanks to the rampant spread of mobile

technology across developed and emerging markets, consumers will increasingly require a seamless shopping experience between online and physical stores. Tesco is headed in this direction as the company progressively reduces its exposure to capital-intensive hypermarkets and develops its e-commerce business alongside smaller supermarkets and convenience stores. All three channels will experience faster growth than hypermarkets globally (Planet Retail, 2015).

In addition, Tesco.com has been innovating to stay ahead with the launch of market-leading tools, such as a shopping app for the iPhone, Andriod, and iPad, its Click & Collect drive-through supermarket, and virtual supermarkets, and the creation of its own Hudl Tablet.

Applications for Smartphones and Tablets

British consumers today can shop anywhere and anytime via their mobile phones, using the free Tesco grocery shopping app for smartphones. The app offers benefits such as the use of an embedded barcode scanner for quick orders, as well as the ability to sync one's orders between multiple devices (Planet Retail, 2015).

Consumers have access to thousands of products online, all of which are deliverable directly to their homes. The "*Tesco's online*" portal, in particular, offers everything from food to hardware to sports equipment. The information available on this site, and others like it, offer great value to vendors looking to gain some market intelligence prior to a market visit or just for strategic planning purposes. Photos of local products are provided, along with their prices, and can give Canadian vendors an idea of what is being sold in Tesco stores in the U.K. This information may also shed light on the potential success of a product in the market. For example, if a Canadian vendor's pricing is not competitive for the U.K.'s market based on an initial online study of market pricing, the U.K. may not be a good fit for the vendor's product (Planet Retail, 2015).

There are also thousands of recipes, videos and cooking tips available on the "*Tesco Real Food*" site. Customers can also find recipes via Tesco's free "Recipe Text Service," which allows Tesco mobile users to receive a list of relevant recipes on their phones by texting a key ingredient to 'COOK'. These recipes are offered by Tesco based on their knowledge of their customers' preferences and can provide information to vendors as to the ingredients and flavours that are popular among this segment. This type of market intelligence can help vendors identify where their products would fit into the market or how they can add value through cross-category sales (Tesco.com, 2015).

Tesco has expanded the capabilities of its mobile app by offering consumers in South Korea, the opportunity to shop while waiting for the bus or subway by simply pointing their mobile phones at products on billboards. As a result of the positive reaction to their virtual store in Seoul, Tesco launched an interactive virtual grocery store at Gatwick Airport in London to help vacationers shop using their smartphones prior to returning home from their trip (Tesco.com, England, 2015).

Click and Collect Drive-Through

The push towards e-commerce has allowed Tesco to offer a more personalized service to their consumers based on their personal lifestyles and preferences. For example, Tesco's "*Click and Collect*" grocery service offers a higher level of convenience for customers who pick up items frequently, saving them from having to find a parking spot and enter the store to pick up orders. The idea is to save the customer time, for a price. Tesco is working to create efficiencies within the online store to reduce the cost of delivery and to keep their products competitive. (Euromonitor International, 2015)

This service was first offered to British consumers in the summer of 2011 and is very similar to the rapidly growing "*Drive-Through*" service provided by popular French hypermarket Carrefour in France and the United States. By visiting www.tesco.com/groceries, Tesco customers can select the items they want to purchase and pick them up from 300 Tesco "*Click and Collect*" locations (Ourtesco.com, 2015).

The U.K.'s societal shift towards the notion of "commerce anywhere" has given Tesco no choice but to invest heavily in digital solutions to hold onto sales or it would otherwise lose out to other retailers. This shift toward greater convenience for the consumer creates, in turn, a need for efficient supply chain workings on behalf of Tesco, thus affecting its vendors. (Retailweek.com, 2015)

For suppliers this means that they will need to be prepared to have their product's stocked with Tesco so that they can fulfill any online deliveries they receive. Also, presenting information of your product on your packaging so that it can be easily viewed online will be helpful for consumers.

EFFICIENCIES IN THE SUPPLY CHAIN

Tesco has invested heavily in creating a robust and flexible supply chain to minimize costs, maximize profits and reduce the carbon footprint of products sold by 30% by the year 2020. Many of the new processes and systems Tesco has implemented are the result of the evolution of Tesco's online business. Other measures aim to maintain on-shelf availability (OSA), while reducing the number of store replenishment deliveries and reducing stock levels at both distribution centres and stores (Tesco.com, 2015).

New Stock Replenishment Systems

One of Tesco's main priorities is to see a substantial reduction in food waste. The retailer plans to achieve this largely through the use of its automated ordering system, Group Ordering System (GOS) by Oracle. This system was improved and fine-tuned in 2012 to help the retailer to maintain lower inventories. Tesco optimizes fresh food forecasts by programming pre-defined acceptable waste levels into the system, which then suggests an optimal order, including safety stock levels that take promotional effects into account. This has reduced food waste in stores, while improving OSA, and reducing lead-times (IGD Supply Chain Analysis, 2013).

The GOS uses a sales forecast created one or two hours prior to when the order is placed, based on the latest item movement in stores. The order forecast can then be viewed by the vendor through "*Tesco Connect*", the retailer's extranet connection. Tesco's ordering system then validates the distribution center (DC) network's capability to handle the order prior to placement, and then adjusts order volumes if required. Tesco has the capability to adjust order quantities just hours before the products are scheduled to be delivered. The GOS can pull sales data for 48,000 different product lines every hour, allowing for automated replenishments up to three times a day. Although the order process is automated, store managers have the ability to manually manipulate order amounts for selected product lines, if there is an unexpected upturn in demand for a particular product (IGD Supply Chain Analysis, 2013).

Given this optimized stock replenishment system, Tesco expects their vendors to have responsive supply chains and to deliver on shorter lead-times; otherwise they could be subject to penalties. Vendors who are already working with Tesco can use resources like "*Tesco Connect*" and "*Tesco Link*" to assess their performance, which allows them to then collaborate with Tesco to improve their lead-times (IGD Supply Chain Analysis, 2013).

Tesco Connect informs vendors of upcoming promotions and in-store events. The system provides store-by-store sales forecasts for all promotions across the business by statistically analyzing the mechanics of the promotion, the type of discount that will be applied and how it will be featured in-store. The portal also provides details of expected deliveries over seven-day periods. This information allows vendors to develop short- and long-range predictions of order volumes, taking into account depot needs and unit load rounding much earlier than before. This allows vendors to be more responsive and improves both transport planning and OSA.

If not currently in business with Tesco, it is important to be aware of their vendor expectations, particularly with regards to OSA. According to the Institute of Grocery Distribution (IGD) supply chain

analysis, OSA is measured a number of ways within Tesco, including the following:

- Supplier service level to distribution centre (% of supplier orders fulfilled)
- Distribution centre to store supplier service level (% of store orders fulfilled)
- Distribution centre forward stock cover (measured in estimated days' sales)
- Wastage (% of store sales)
- Failure to arrive (% of expected deliveries not made to distribution centres)

In addition, the retailer expects vendors to operate within a pre-determined "three-box model," meaning that they hold their vendors to the following standards:

- **Competent:** Supply chain fundamentals, systems development, better product streaming, review days, lead times, buying quantities, promotions planning
- **Respected:** six-day ordering and deliveries, consolidation, day one for day two ordering, collaborative planning
- **Famous:** seven-day ordering, stockless for ambient and fast moving goods, gap analysis, active improvements in OSA (IGD Supply Chain Analysis, 2014).

Retail Ready Packaging Initiatives

Tesco, long regarded as the leading innovator in Retail-Ready Packaging (RRP), continues to work closely with vendors and manufacturers of store displays, shelves and pallets to improve product packaging and replenishment productivity in-store. These RRP solutions allow products to be moved from the storage room and placed directly onto the shelf, which has removed several stages to the replenishment process. This replenishment process is guided by what Tesco refers to as the "*Five Easys*", namely, stock must be (IGD Supply Chain Analysis, 2013):

- Easy to recognize in the warehouse (using symbols to identify products rather than words)
- Easy and quick to open (to reduce the time taken to replenish)
- Easy to replenish with only one touch – shelf-ready packaging that allows store personnel to put multiple units on a shelf at one time rather than placing items one by one
- Easy for customers to shop, offering improved product presentation
- Easy to collapse/break down packaging and remove the equipment from the stores

For example, Tesco has worked closely with their bread suppliers to develop one style of tray and trolley to be used by all suppliers of bagged, sliced bread, to create a harmonized look and reduce inefficiencies. The new system allows delivery staff to wheel out bread deliveries to their respective aisle and place trays onto existing shelving units. Individual loaves of bread are no longer touched by store personnel, thereby minimizing damage sustained during delivery processes.

Supply chain efficiency has also been improved with the introduction of the K-roll pallet. The K-roll pallet has a foot-activated mechanism that, when kicked by a store operator, lifts runners to expose wheels. When the mechanism is kicked in the opposite direction, the runners lock down and the device reverts to being a stationary pallet. These are stackable when empty and loaded, allowing store personnel to replenish stock quickly and efficiently.

These delivery aids illustrate how leading retailers are reducing lead times and adjusting their expectations of vendors; vendors should consider how they can make their offering more attractive by offering such replenishment efficiencies.

Sustainability

Tesco has ambitious goals to reduce energy consumption and related costs, and to contribute to national energy security and resource efficiency by reducing carbon dioxide emissions. Tesco emitted 5.7 million tonnes of carbon dioxide in 2012, but plans to become a zero-carbon company by 2050. This is expected to be achieved in part by using renewable resources to generate all of the company's electricity, heat, and

cooling. Moreover, Tesco aims to reduce all vendor-related emissions in its supply chain by 30% by 2020, which means encouraging vendors to cut their carbon dioxide emissions in line with Tesco's objectives. The strategy to achieve this is built on four pillars, wherein deliveries must provide (IGD Supply Chain Analysis, 2013):

- Fuller cages/pallets
- Fuller trucks/containers
- Fewer miles
- Fuel economy

For now, Tesco has taken an "operational control approach" to measuring its direct carbon footprint, which refers to managing emissions that the company has full authority over. These emissions are the result of fuel consumption and refrigerant leakage from company operations on Tesco property, distribution processes, and business travel. To help reduce these emissions, the retailer is also currently working with vendors on initiatives such as front-haul trucking to ensure vehicles do not travel empty after making a delivery. For example, the front-haul approach uses vendor vehicles that have made deliveries to Tesco Distribution centers to deliver store orders on their return trip. The company has also sought to reduce carbon dioxide emissions by distributors hired on contract by Tesco, thus extending its sustainability efforts beyond its immediate supply chain.

Furthermore, Tesco has estimated the carbon footprint of 1,100 products it carries by calculating the carbon dioxide emissions of their vendors. The company believes these emissions are ten times as large as Tesco's direct carbon footprint, and Tesco hopes to reduce these vendor-related emissions by 30% by 2020. The methods for accomplishing this include (Tesco.com, 2015):

- **Sustainability projects:** These projects measure vendor emissions and provide them with recommendations to reduce carbon dioxide in supplier facilities, such as farms and factories.
- **Knowledge Hub:** This is an online community of Tesco's 1,000 largest vendors, in which they share best practices using case studies, webinars, site visits, and forums.
- **Packaging data requests:** Tesco has asked vendors to provide the company with detailed information on their packaging design, which hints at possible packaging guidelines to come.

Though these projects and initiatives appear to be voluntary for vendors, they could someday be incorporated into Tesco's buying standards. Vendors therefore have an incentive to comply, if not actively participate, in these projects, if they wish to continue working with Tesco in the future.

Supplier Changes

Tesco is changing their strategy with suppliers. Currently there are 24 different ways that Tesco can charge suppliers; this will be reduced to only three, some of the types of charges include: product placement, promotions, recalled products, and late deliveries. The retail industry has become dependent on these different revenue streams; for example, retailers could take compensation so that their products would have premium space in their store, or even to help pay for in-store promotions. Morrisons, which is the first U.K. supermarket to reveal commercial income from suppliers, publicized that about 70% of their payments from suppliers are to help pay for in-store promotions of the supplier's products (Telegraph, 2015).

Tesco and other retailers like Asda and Sainsbury have added thousands of products over the last 5 years; this has been blamed on the reliance of supplier payments. However, now supermarkets are attempting to reduce the number of products offered in their stores so that they are able to organize their shelves with their customers in mind, instead of their suppliers (The Guardian, 2015). Tesco has formalized this process and have called it "Project Reset". Project Reset, will look to reduce SKUs by 20% over the next few years. Tesco is aware of the dangers of cutting their products, some product cuts will affect their customers negatively and with this knowledge Tesco is going to be moving forward cautiously (The Grocer, 2015).

CONCLUSION

Tesco recognizes the need to focus on innovation in order to grow as a business. This is more important than ever, as the company predicts that the way consumers shop and pay for their purchases will change more in the next few years than in the last twenty put together. Tesco is striving to be at the forefront of this change.

Innovation at Tesco will continue to be driven by understanding the needs of consumers and bringing in products and services that will be valuable and useful. Also, by understanding and identifying how technology can be applied to meet changing consumer needs. Tesco is working on making their "*Click and Collect*" more accessible and opening smaller stores in convenient locations to reach more consumers.

Tesco is also working on repairing relationships with suppliers and finding new ways to handle contracts with them. In most markets, only a handful of supermarket gatekeepers stand between thousands of vendors and their target markets. This leaves vendors with few large, alternative buyers and considerably less bargaining power. As Tesco and other retailers are now reducing the number of suppliers they have, it will be important to stand out now more than ever for a supplier, with innovative products and efficient cost savings through supply chain or other management practices (Uk.Reuters, 2015).

FOR MORE INFORMATION

International Trade Commissioners can provide Canadian industry with on-the-ground expertise regarding market potential, current conditions and local business contacts, and are an excellent point of contact for export advice.

- **Overview of Trade Commissioner Services in U.K.**
  http://www.tradecommissioner.gc.ca/eng/contact-our-team.jsp?oid=36&cid=114

- **Find a Trade Commissioner**
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- ats-sea.agr.gc.ca

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